



# **Reducing Tax Rates Through Revenue Triggers**

## *Kansas, North Carolina, and Colorado*

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### **Preface:**

Since the Republican wave of 2010, two states in particular have set out to consolidate state income tax brackets while reducing rates in a dramatic way. Kansas Governor Sam Brownback made tax reform a priority in his first four years in office, while North Carolina Republicans have enacted one of the most aggressive tax cuts a state has ever seen. In both cases, the legislation contained key provisions that include revenue triggers that would reduce tax rates further when state revenue collections hit a certain percentage. Colorado, when it enacted the Taxpayer Bill of Rights or TABOR, imposed a trigger provision as well – however the language of the provision allowed for legislative abuse. This paper will outline how each state’s provision works and why Kansas and North Carolina have superior revenue triggers to Colorado.

### **Kansas:**

During the 2012 legislative session, Kansas Republicans at the urging of Governor Sam Brownback began the process of tax reform. The Governor made it his goal to set the state on a path to ending its state personal income tax. To achieve this goal, legislation was drafted that would “clean up” the tax code by eliminating certain credits and deductions, and consolidating income tax rates. Many of the “pay-fors” in the legislation were removed by a group of state senators with the intent to kill the legislation by making the income tax rate reductions too aggressive. This however was unsuccessful and the legislation was passed. In 2013, the Kansas legislature returned to the tax reform process and passed House Bill 2059. This legislation reinstated some “pay-fors” from the previous tax cut as well as addressing changes to the state sales tax. Most importantly, however, HB 2059 enacted a revenue trigger provision that would allow for Kansas to reach the goal of ending the state income tax. The key provision:

*New Sec. 6. (a) (1) Except as provided in subsection (a)(2), commencing with fiscal year 2018, in any fiscal year in which the*

*amount of selected actual state general fund receipts from such fiscal year exceeds the selected actual state general fund receipts for the immediately preceding fiscal year by more than 2%, the director of legislative research shall certify such excess amount to the secretary of revenue and the director of the budget. Upon receipt of such certified amount, the secretary shall compute the excess percentage increase in selected actual state general fund receipts about 2%. Based on such excess percentage of calculation receipt growth, the secretary shall compute the income tax rate reductions to go into effect for the next tax year that would reduce by such certified amount the tax rates during the fiscal year after the next fiscal year according to the provisions of this section as follows: (A) Rate reductions for individual income tax rates shall be applied to reduce the highest marginal income tax rate applicable to the current tax year, by such excess percentage minus 0.5%, and the lowest marginal income tax rate applicable to the current tax year by such excess percentage plus 0.5%, except that in no case shall such excess percentage plus 0.5% result in an income tax rate increase. In any such computation by the secretary pursuant to this subsection: (i) The resulting income tax rate shall be rounded down to the nearest 0.1%; and (ii) in any case in which the income tax rate for any individual marginal income tax rate is below 0.4%, such rate shall be 0%. Based on all such determinations, the secretary shall reduce individual income tax rates prescribed by K.S.A. 79-32,100, and amendments thereto, as required by this section;*

*(B) upon all individual marginal income tax rates being reduced to 0% pursuant to the provisions of subsection (a)(1)(A), rate reduction next shall be applied for the surtax on corporations applicable to the current tax year by such excess percentage. In any such computation by the secretary pursuant to this subsection in which the surtax is below 0.4%, such surtax rate shall be 0%...*

The provision continues until rates reach 0% for individuals, corporations, and national banking associations, state banks, trust companies, and savings and loans associations.

The trigger provision in HB 2059 should be considered model.

## **North Carolina:**

North Carolina has enacted an equally aggressive income tax reform; however, North Carolina's trigger provision addresses only the state corporate income tax and does not reach a 0% rate.

The key provision in HB 998:

*Section 2.2.(b) Part 1 of Article 4 of Chapter 105 of the General Statutes is amended by adding a new section to read:*

***“§ 105-130.3A. Rate reduction trigger.***

*If the amount of net General Fund tax collected in fiscal year 2014-2015 or fiscal year 2015-2016 exceeds the anticipated General Fund tax collections for that fiscal year, the rate of the tax set in G.S. 105-130.3 [the state corporate income tax rate] may be decreased in accordance with this section effective for the taxable year that begins on the following January 1. The amount of net General Fund tax collected for a fiscal year is the amount reported by the State Controller in the State's Comprehensive Annual Financial Reporter, required to be prepared under G.S. 143B-426.39. The Secretary must monitor the net General Fund tax collections and notify taxpayers if the rate decreases under this section. The rate is decreased by once percent (1%) if the net General Fund tax collections for fiscal year 2014-2015 exceed twenty billion two hundred million dollars (\$20,200,000,000). The rate is decreased by one percent (1%) if the net General Fund tax collections for fiscal year 2015-2016 exceed twenty billion nine hundred seventy-five million dollars (\$20,975,000,000). Effective for taxable years beginning on or after January 1, 2017, the rate of tax set in G.S. 105-130.3 is the rate determined in accordance with this section.”*

In essence, HB 998 reduced the state corporate income tax rate from 6.9% to 5% after passage. The legislation contains a trigger provision, however, that would see that rate reduced twice more if certain revenue requirements are hit. If the revenue requirements are met, by 2017 the corporate income tax rate in North Carolina would be set at 3%. After 2017, the revenue triggers would not reduce the rate any further.

## **Colorado:**

The implementation of TABOR in Colorado should serve as an example of how not to impose revenue triggers for tax reductions. Enacted via a state constitutional amendment, TABOR placed spending limits on the state of

Colorado. Excess revenue – that is revenue taken in that is above the state spending limit – would be refunded to the taxpayers as essentially a rebate.

The key provision:

*(7) SPENDING LIMITS. (a) The maximum annual percentage change in state fiscal year spending equals inflation plus the percentage change in state population in the prior calendar year, adjusted for revenue changes approved by voters after 1991. Population shall be determined by annual federal census estimates and such number shall be adjusted every decade to match the federal census.*

*(b)...*

*(c)...*

*(d) If revenue from sources not excluded from fiscal year spending exceeds these limits in dollars for that fiscal year, the excess shall be refunded in the next fiscal year unless voters approve a revenue change as an offset.*

By not mandating a triggered rate reduction and instead opting for a tax refund mechanism, Colorado lawmakers gave enough leeway to render the spending limits null and void if the excess tax revenue was used in a particular way. Instead of allowing for TABOR to enact tax refunds, lawmakers used excess revenue to doll out credits to political allies and key voting blocks in the state. TABOR was rendered null and void as in many cases; the credits looked more like spending than any sort of tax refund for Colorado taxpayers.

### **Conclusion:**

When considering revenue triggers as a means for rate reduction in tax reform, Kansas and North Carolina stand out as ideal while Colorado falls short of achieving anything useful. The Kansas model is an aggressive but long term approach to achieving a 0% tax rate while North Carolina looked to aggressively reduce rates over a shorter window but ultimately does not take the state to a 0% rate on corporate or personal income taxes. Americans for Tax Reform is hopeful that the language used in Kansas and North Carolina will be adopted by other states as they consider comprehensive tax reform.